

**THE JOINT COMMENTS
OF
THE CITY OF CHICAGO,
THE ATTORNEY GENERAL OF ILLINOIS,
AND
THE COOK COUNTY STATE'S ATTORNEY'S OFFICE**

Submitted: April 23, 2004

These Joint Comments are submitted by the City of Chicago (the City), the Attorney General of Illinois (AG), and the Cook County State's Attorney's Office (collectively, Governmental Parties).¹ The Joint Comments are presented in three sections. First, the Joint Comments examine the over-arching legal and policy imperatives that -- by law -- must shape the Illinois Commerce Commission's (ICC or Commission) determinations regarding post-2006 market and regulatory structures. These requirements are drawn from the existing mandates of the Public Utilities Act (PUA or the Act) and do not represent new demands on utilities, customers or other entities affected by state regulation. Second, the Comments address certain concerns that Governmental Parties have about the process for addressing post-2006 issues established by the ICC's *Rules of the Road* document. Finally, the Comments present the additional questions and accompanying narrative originally filed by the City of Chicago.

These comments represent initial positions and provide a context within which this process can be efficiently conducted. The City, the AG, and CCSAO hope to learn from the sharing of information and perspectives during this process.

SECTION I

Legal and Policy Requirements

for Post-Transition Electricity Supply and Services

At the outset we wish to emphasize a basic concern that should permeate the discussions in this process. The Commission and other stakeholders must recognize -- and prepare for -- the possibility that market developments will fail to achieve the optimistic expectations of those who supported the introduction of competition into the Illinois electricity industry. Accordingly, one aspect of proposed market and regulatory mechanisms that should be examined closely in this process is the proposed regime's capability to "fail softly" if the projected market developments or other forecasts are wrong. With respect to electricity, which is essential to industry and commerce, as well as to every Illinois resident, we cannot afford expensive mistakes. The Commission must not prescribe policy based on faith in the invisible hand, without allowing for the possibility that it may be wielding an invisible stick.

Much has been made of the absence of any retail competition for residential customers, despite the theoretically open market. Governmental Parties are all public advocates, yet we do not deem the lack of retail competition to date as evidence of the failure of restructuring, because the market and regulatory structures put in place during the transition period anticipated that price-

¹ The City and CCSAO, along with the Citizens Utility Board, are separately filing joint comments that respond to certain of the questions included in the *Illinois Commerce Commission Post 2006 Initiative – Final List of Issues*.

constraining competition would not develop for residential customers. We have yet to see evidence from anywhere in the country that price-constraining retail competition is viable for small-volume customers. Will retail options for residential and small business consumers burst forth in Illinois with the end of transition charges and the unfreezing of utility rates? It seems unlikely for many reasons. However, the regulatory task at hand is not to predict the future, but to plan for contingencies. It is not the job of state regulators to “promote” the appearance of retail marketers in Illinois. The objective should be pragmatic, not ideological: to determine the optimal combination of regulatory and market means to achieve the social goals that remain at the heart of the Act.

The range of options available to the Commission and Illinois stakeholders is not unbounded. Even as stakeholders and the Commission embark on a quest for innovative solutions to the unique problems of this transition, we must take account of the historical and current requirements of law and expectations of stakeholders. Consensus on some key issues appears unlikely, given the differing interests of stakeholders. However, the adoption of non-consensual policies that have the effect of reducing consumer protection or increasing the obligations and risks of service providers will be problematic, particularly if legislative changes are required. Therefore, this process should seek to identify our real options, given the legal, market and political factors in place, and focus the workshops efforts accordingly. It will take leadership from the Commission to achieve such an outcome.

Electric utilities are obligated to continue offering tariffed bundled service to residential and small commercial customers after 2006. (220 ILCS 5/16-103(c)). In defining realistic options, certain fundamental characteristics are requisites for public acceptance of any post-transition regime, particularly with regard to the procurement and pricing of regulated services provided to residential and small business customers. First, any regulatory and/or market-based regime for provision of these bundled services must assure the adequate, efficient, safe, reliable, environmentally safe, and least-cost supply and delivery of electricity. (220 ILCS 5/ 1-102). Second, the rates for consumers must be just and reasonable, whether the Commission relies on regulatory or market mechanisms – or some combination thereof -- to achieve that result. (220 ILCS 5/9-101).

Rates for end-use consumers must also be affordable and reasonably stable. Because utilities no longer own most generation facilities, this will require that utilities prudently use the bulk supply and price hedging opportunities available for the large pooled demands their regulated service customer bases provide, so as to protect those customers against wholesale price risks that small-volume end-users individually cannot manage economically.

We hope that all stakeholders share our commitment to affordable rates and also to universal service, an unachieved goal that should not be abandoned in the post-transition era.

Regardless of the specific measures that are eventually adopted, the Commission must continue to follow all the public interest directives of the PUA, adapting and interpreting them as appropriate to the changing circumstances in which they will be applied. The policies that are implemented will ultimately be judged by how well they achieve these enduring public goals.

There are, however, some specific factors that must be addressed by any new regime for the post-2006 period. Some arise from the realities of the Illinois marketplace and others arise from changes in the consensus on enlightened public policy.

Current Illinois Electric Marketplace

The current state of the electric services markets may affect the suitability of particular potential procurement procedures for provisioning regulated service customers. There are many questions raised by the current market: Does consumer protection require vigorous regulatory oversight and enforcement? Is there a need for regulated bundled services that is attributable to the absence of effective market forces? Is the current state of competition in Illinois electricity markets -- which have failed to develop as predicted -- adequate to preserve the goals of the electric restructuring act? Illinois utilities have sold or transferred most of their generation capacity, much to affiliated companies. The Commission must work to assure that customers are protected from potential exercises of market power by entities with concentrated supply or purchasing positions.

We must assume that retail competition for residential and small commercial customers will not be viable for the foreseeable future. Against this backdrop, the Commission must determine the structure under which electric utilities will procure wholesale power and energy for residential and small commercial customers. Under those circumstances, any post-2006 bundled tariff structure must address:

1. what kind of procedures will be necessary for the Commission to promote market transparency and fairness and ensure that electric utilities provide reliable energy services at the least possible cost;
2. what kind of oversight the Commission will have over compliance with these procedures by electric utilities or their procurement agents;
3. the adequacy of its current rules for checking affiliate abuses; and
4. how and to what degree the cost of procuring power will be reflected in residential and small commercial rates.

Renewable Energy Resources

The growing consensus regarding post-2006 power procurement is that Illinois utilities will develop a diverse portfolio of supply resources, pursuant to express mandates for increased use of renewable energy resources. This policy position has gained steadily when presented in legislative proposals and will be at issue in the Commission's workshops. Any such renewable portfolio standard should be a meaningful standard, not long-term studies or mere "targets" that may actually result in little or no change in resource mix. The commitment to renewable energy resources can be made now, even before there is an adequate, fully developed market for renewables -- just as the commitment to deregulated electricity supply was made before a fully functioning market had developed.

The diverse resource mix required should include both long-term and short-term resources and demand side resources. This process must also define whether there will be (and the bases for) periodic adjustments. How to deal with potentially higher direct costs of certain renewable resources -- without transferring all price risk to customers -- and the cost of managing the mix of market supply components may be issues that are more difficult to resolve.

Especially as to power procurement, a rational development process must begin with an investigation of the pertinent market facts. Those facts will determine the need for and the appropriate direction of Commission actions on procurement rules, customer protection, resource portfolios, risk management, and regulated services rate structure.

SECTION II

Concerns About the Process Established in the ICC's *Rules of the Road*

The workshops must have the specific goal of communicating their accomplishments to the Commission and continuing the policy dialogue on post-2006 electricity supply and services.

Governmental Parties are compelled to comment upon the need for a more specific goal(s) for these workshops. The substantive discussions the parties anticipate will not take place in a vacuum. The *Rules of the Road* issued in connection with this initiative states that each of the five working groups must produce a Final Report by September, but there is no indication as to what will happen with that report. Supposedly, it will be submitted to the Commission. Will it also be submitted to the legislature? Will it be made publicly available by posting through the Commission's website? What actions might be taken on the basis of those reports? These questions are not answered.

Governmental Parties suggest that an extra effort be made to facilitate direct communication between stakeholders and the Commissioners. We propose, in addition to the Final Reports which the *Rules of the Road* indicates are due from each working group, that the workshops also result in a series of live panel presentations to the Commission, one on each of the five broad issues set forth in the Issues List (Rates, Power Procurement, Competitive Issues, Utility Service Obligations, Energy Assistance), that explain those issues upon which consensus has been reached and those that remain unresolved. Panelists should be chosen by the Parties to represent the various points of view (though not necessarily the views of each individual workshop participant) that are sure to arise during the course of discussions on each of the five topics.

The panels should be conducted within a relatively short time frame (one every week or two). Their primary purpose should be to provide the Commissioners with an opportunity to engage the panelists in open and frank discussions on their perspectives and how the workshop process affected their view of the issues. The Commissioners' review of the written Final Reports will obviously be helpful, but live interaction between selected workshop participants and the Commissioners is essential to help distill the best of the workshop experience for the regulators who must ultimately make the final policy decisions.

Of course, it is not expected that the panel presentations will mark the end of the many policy debates needed to complete the post-2006 planning process. But they can at least build the first of what hopefully will be the many intellectual bridges between the stakeholders and the Commission that will be needed to complete this important regulatory transition.

The workshop schedule is too compressed to generate meaningful participation from a wide group of stakeholders.

The Commission should not lose sight of the fact that few stakeholders have the resources to participate fully in the workshop process as it is now designed. Resource allocations being what they are, most stakeholders have, at best, two or three individuals capable of making meaningful contributions to the workshops on a regular basis, and these individuals have other responsibilities that will prevent them from attending every meeting – or even most meetings – on any given topic. (For example, a great many stakeholder representatives will be actively litigating the Ameren-Illinois Power reorganization this summer, a case that may be conducted on an expedited basis.) Some stakeholders have only one qualified individual who can represent their interests. Many representatives are not located in Chicago or Springfield and would have to travel significant distances to make any meetings at all. Therefore, with the exception of a few particularly well-financed utilities, likely participants are ill equipped to send representatives to weekly meetings for each of the five topics for 12 consecutive weeks or more at any time of the year, let alone 12 consecutive weeks in the summer.

Governmental Parties urge the Commission to reconsider the expedited time frame and daily format proposed for these workshops so that the process can benefit from the

participation of a sufficiently representative group of stakeholders. With that in mind, we propose the following adjustments to the proposed format:

1. Rather than schedule one meeting a week on each of the five topics included in the *Rules of the Road* every week for 12 weeks, there should be no more than two meetings a week. These meetings should take place preferably on consecutive days so that out-of-towners do not need to duplicate trips. Two consecutive days of meetings can be worked into most schedules, will help focus the parties' efforts, and will lead to more concentrated, more productive meetings. This allows parties to focus on one topic at a time, e.g., all Power Procurement meetings, then all Rates meetings, etc., or, in the alternative, on no more than two topics simultaneously.
2. Parties should be given until the end of this year to complete their discussions and issue their Final Reports. There is no reason why we need an expedited process, especially if the Commissioners get a chance to question stakeholders as explained in the panel discussion format proposed above. Furthermore, it is unrealistic to think we will get optimal participation during the summer months. All the parties are familiar with how summer vacations and family responsibilities prove inflexible even in the face of tightly planned litigation schedules.

SECTION III

This section of the Joint Comments is essentially the re-submission of the City's proposal for an alternative framework for examining the identified questions at issue. So that this section is faithful to the original submission, it includes the "additional questions" identified in the original submission, even though they appear to have been added already to the Final List of Identified Questions published on the Post-2006 Workshops website.

City of Chicago's

Additional Questions and

Scenarios for Post-Transition Electricity Supply

An Alternative Framework for Analysis and Discussion

Proposal Objectives

This submission proposes a framework for the analysis of post-transition issues and for the development of regulatory and market regimes for the provision of

electricity after 2006. The objective of the proposal is to advance the productivity of stakeholders' participation in the Commission's Post 2006 Initiative.

The slate of issues developed by the Staff³ deserves the considerable praise it has received. However, those issues are defined only by brief comments and the categories to which they are assigned. Placing the issues and questions in the context of practical implementation scenarios would give them more precise meaning, demonstrate their relevance (or expose their irrelevance), and reduce the number of possible issue combinations to discuss. We propose that the Commission consider addressing post-2006 issues in the context of defined proxies for the (relatively few) credible post-2006 scenarios the Commission might reasonably endorse -- instead of as detached theoretical inquiries.

Whether the scenarios outlined below are the "right ones" is not the point of this proposal. A different slate of scenarios for comments and workshop discussions could be produced by the proposed Steering Committee, by the Commission Staff, or through input from stakeholders. Such a framework could also mitigate the time and resource limitations that challenge stakeholders in this process. Since few parties have the resources to examine each issue in all possible settings, common starting points should advance our discussions. Finally, real world context and practical considerations will prompt valuable insights that theoretical debate is unlikely to disclose.

Defining Scenarios

Some aspects of post-2006 electricity supply in Illinois can be defined even at this early date. First, it is clear that under Illinois law the distribution level delivery function will continue to be a monopoly service of electric utilities. Second, the market/regulatory structure for transmission services in Illinois (though currently in transition) is outside the jurisdiction of this Commission.⁴

Staff's slate of issues reflects these boundaries on the proper inquiries of this process. The principal focus of the issues identified in the Introduction is the generation sector. The main task at hand is to define procedures for acquiring electricity supply for utilities' bundled services. It is likely that smaller customers will remain tied to those services for the foreseeable future. Specifically, the Commission must determine how utilities should approach the wholesale market for an adequate and reliable supply to provide tariffed bundled services at just and reasonable prices, how acquisition responsibilities and risks will be assigned, and how to oversee the costs of acquiring supply that are passed to consumers.

The separate issue categories labeled "Rate Options" and "Competitive Issues" in Staff's Introduction will be present under any of the scenarios defined. The rate issues arise in any scenario that contemplates a continued dependence in the near future on tariffed (instead of competitive) service by residential and small commercial customers -- regardless of how electricity supplies are procured.

(There are, however, some ratemaking issues that are peculiar to distinctive scenarios -- e.g., risk management obligations and costs in a scenario without regulated resource planning.) Similarly, competition issues are important until there is effective competition in all market segments. Those questions are pertinent for the anticipated non-competitive residential and small commercial market segments, without regard to a utility's method of procuring wholesale supplies.

The relevant scenarios relate mainly to utilities' procurement of generation resources for the provision of bundled services. Below are outlines of three plausible scenarios that encompass the questions identified by Staff. These scenarios do not define the scope of the proposed workshops, rather they provide a realistic context, within which the post 2006 issues can be evaluated. We encourage the Commission and other stakeholders to build on this modest beginning.

Scenarios

* **Common Elements.** In any of the most plausible scenarios of a post-transition regime of regulatory and market structures, the following circumstances are likely to be present.

* The Commission recognizes the post-2006 realities suggested by the Introduction -- viz., that residential and small commercial customers will not have effectively competitive alternatives to the provision of electricity by incumbent utilities. What competition may exist for those customers will not be sufficient to assure adequate, reliable service at just and reasonable rates. The Commission, therefore, continues economic regulation of the tariffed bundled services that the PUA (*16-103) requires Illinois electric utilities to offer.

* The fact that most (if not all) Illinois public utilities have sold or transferred their generation assets to non-utility enterprises, requires the acquisition of electric power and energy in a deregulated wholesale market.

* Utilities are likely to propose that bundled services -- and bundled service rates -- be made up of a combination of Commission regulated delivery services, federal jurisdiction transmission services (whether at regulated or market rates), and unregulated generation supplies. The Commission will regulate rates for tariffed bundled services by exercising its jurisdiction over (a) the costs and rates of delivery services, (b) the pass-through of prudently incurred transmission costs, and (c) the prudence of utilities' practices and costs in the acquisition of generation supplies.

*** Scenario 1 -- Continue Current Regulation**

The Commission finds that:

- * Retail competition is not sufficient to protect end users from the pass through of volatile, potentially high wholesale prices (Intro, 2);
- * The current wholesale market is immature, contains market power imperfections, and lacks robust, effective competition that can assure prices at competitive levels for all customers (Intro, 3);
- * The results of efforts to transform the transmission system to support an effectively competitive market are uncertain (Intro, 3); and
- * These factors are likely to persist for some time after 2006 (Intro, 3).

The Commission therefore determines that it should continue current regulation and oversight.

In reaching this conclusion, the Commission observes that no component of the likely required post-transition regulatory processes is foreign to its experience. That is, the Commission has historically regulated the terms and rates of both distribution and transmission delivery services, and it has overseen the supply acquisition practices and costs of both gas and electric utilities. (Even the issue of resource planning has been before the Commission previously.) However, the scale of future acquisition activities, newer perspectives, and a broader range of possible arrangements does present some novel questions.

As to specific regulatory processes, the Commission looks first to its prior experience with specific aspects of its historical regulatory approaches. But, that backward-looking perspective is modified by the lessons of recent experience (in Illinois and other places), which have yielded a greater appreciation of the need or the demand for: greater use of renewable energy resources; full, fair consideration of demand response resources for inclusion in utilities* supply portfolios; policies and practices that encourage conservation and efficiency of usage; policies that encourage the development of effectively competitive markets where possible; and candid assessments of the effectiveness of competing approaches in advancing the public interest and achieving promised benefits for consumers.

As a result, the Commission continues its economic regulation of the narrower range of services under its jurisdiction, and it conducts periodic prudence reviews

of utilities* procurement practices and costs. At the same time, the Commission reaffirms its support for policies that foster greater competitiveness in wholesale and retail electricity markets.

*** Additional Questions/Issues**

**** How will the Commission address the special cost allocation and affiliated interest problems that accompany a utility with joint costs for regulated and unregulated activities?***

**** Cost of Service or Price Cap regulation -- Regulation of rates for tariffed electric services has traditionally been on a cost-of-service basis. Only the telecommunications markets, with mandated retail competition structures, have been deemed sufficiently competitive for price cap regulation. What criteria will be used to determine the sufficiency of competition?***

*** Scenario 2 -- Integrated Resource Planning**

The Commission finds that:

* Whether the Commission uses the market or regulatory oversight to assure just and reasonable rates under the PUA, environmental externalities, which have skewed the choices and prices of electric utility services in the past, should be incorporated into the regulatory process; *

* The sale of their generating assets by Illinois utilities will require many utilities to procure electricity for their tariffed bundled services on the wholesale market (Intro, 1, 2, 4);

* Affiliations between utilities and wholesale electricity producers present a potential for favoritism in the procurement of power and energy that cannot be ignored, and current concentrations of selling and buying power in Illinois exacerbate the potential for exercises of favoritism or market power (Intro, 3);

* Retail competition alone is not sufficient to protect consumers from the retail effects of volatile, potentially high prices in a wholesale market that is not yet fully competitive (Intro, 2);

* A regulatory regime that incorporates specific portfolio requirements, a fair, transparent process for competition in the procurement of utility supply, prudent risk management, and planning for both short and long term needs will best ameliorate the effects environmental externalities and the described market weaknesses, while assuring just and reasonable prices for regulated services. *

* The Commission therefore requires that each electric utility

* Seek and obtain regulatory approval of a resource plan detailing specified aspects of its proposed resource selection, procurement, and risk management processes.

* Utilities operating under approved plans will enjoy a presumption that their activities and the resulting costs are just and reasonable.

* A utility is required to report significant changes in the circumstances or projections on which approval of its plan was based.

Questions about the effectiveness of past Least Cost Planning efforts are deemed to be outweighed by (a) public policies driven by long-term health, environmental, and energy concerns, (b) the imperative to protect end-users from retail price volatility and extreme variability attributable to wholesale price behavior; (c) the need to foster greater competition in the less than fully competitive, deregulated supply markets; as well as (d) the environmental gains of resource planning under Commission oversight. Among the expected ancillary benefits are more readily available and reasonably priced "green power" products, long term planning to assure adequate supply at reasonable costs, less pollution from the generation of electricity, and transparency in electricity supply procurement.

*** Additional Questions/Issues**

*** How should any changes in cost of supply attributable to "green power" portfolio requirements be apportioned?**

*** Or, do the societal benefits of more environmentally aware resource planning and utilization obviate any need to trace such costs (or savings) to "green power" consumers?**

**** [The factual basis for Commission findings (especially those marked with asterisks, which are not addressed in Staff's introduction) will be additional issues.]***

*** Scenario 3 -- Full Reliance on the Wholesale Market**

The Commission finds that:

* The wholesale electricity market serving Illinois utilities is sufficiently competitive to overcome reservations related to the concentration of buyers and sellers, potential market power, and transmission service uncertainties (Intro, 2-3).

* The competitiveness of the wholesale market is adequate to produce just and reasonable rates at the retail level without regulatory intervention by the Commission. *

* Remaining issues -- such as modifications of affiliate rules, risk management responsibilities, and environmental policy requirements -- can be addressed through regulatory rules that do not involve economic regulation of utility rates beyond the determination of reasonable administrative charges as provided in *16-111 of the PUA. *

The Commission, therefore, orders that:

* Utilities must continue to provide tariffed bundled service as required by the PUA, but they will purchase their electricity supplies in the competitive wholesale market.

* Utilities are allowed to recover just and reasonable costs of the electric power and energy component of bundled service rates

* Utilities retain the default provider obligation and associated risk management responsibilities for bundled service ratepayer supplies.

*** Additional Questions/Issues**

**** What if the incumbent does not wish to retain the default service responsibility?***

**** Is an alternative arrangement feasible, given the incumbent's distribution monopoly and obligation to***

operate the system reliably (even if there are supply imbalances)?

**** [The factual basis for Commission findings (especially those marked with asterisks, which are not addressed in Staff's introduction) will be additional issues.]***